Asia Bond Monitor Highlights

Bond Market Outlook

Bond yields in most emerging East Asian markets declined between the start of the year and mid-February amid mounting gloom over global growth prospects.[1] The main exceptions to the downward trend were the People's Republic of China (PRC) and Hong Kong, China. Bond yields also fell in major advanced economies due to subdued inflation and concerns over deflation in some economies.

With growth momentum in the United States (US) slowing, the US Federal Reserve held interest rates steady in January following the first rate hike in 9 years in December. In the eurozone, growth remained lackluster and the European Central Bank decided to continue its quantitative easing policies in order to stave off deflation. In Japan, the economy grew by only 0.5% in 2015. In response to a sharp drop in industrial production and tepid inflation, the Bank of Japan introduced negative interest rates in January.

Yields for 10-year local currency (LCY) government bonds in emerging East Asia mostly fell between 1 January and 15 February. Over the same period, most emerging East Asian stock markets also fell, with the only exceptions being in Indonesia, where the market rose, and in Thailand, where the market held steady.

The region's foreign exchange markets were mixed between 1 January and 15 February. The Korean won depreciated by 3.0% and the Philippine peso weakened by 1.2% against the US dollar, while the Indonesian rupiah and Malaysian ringgit appreciated by 3.3% and 3.8%, respectively. The region's other currencies were more or less stable, with only the Thai baht appreciating by more than 1%.

Credit default swap spreads across emerging East Asia have remained volatile over the same period, mirroring the lingering uncertainty about the region's growth prospects. Risk premiums in emerging East Asian bond markets have been on the rise as well.

Risks to emerging East Asia's bond markets have intensified since the start of the year. The Federal Reserve may raise interest rates within the first half of the year, which could generate outflows from the region's bond markets. However, a gradual and cautious increase in interest rates, combined with emerging East Asian bond markets having already factored in US monetary policy normalization, suggest that the adverse impacts will be limited. At the same time, the strengthening US dollar could adversely affect corporate balance sheets and exacerbate funding challenges for companies that have borrowed in US dollars. A broader loss of investor confidence in emerging markets looms as the single biggest risk.

LCY Bond Market Growth in Emerging East Asia

Emerging East Asia's LCY bond market expanded 5.0% quarter-on-quarter (q-o-q) and 17.8% year-on-year (y-o-y) in the fourth quarter (Q4) of 2015, with the outstanding bond stock amounting to USD9,105 billion at the end of December. The three fastest growing markets on a q-o-q basis were those of the PRC; Hong Kong, China; and Malaysia—while negative q-o-q growth was recorded in Singapore.

The largest bond market in emerging East Asia remained the PRC's, with an outstanding bond stock of USD6,150 billion at the end of December, which accounted for 67.5% of the region's total.

The amount of LCY bonds outstanding as a share of the region's gross domestic product rose to 63.9% in Q4 2015 from 61.7% in the third quarter (Q3) of 2015, driven by quarterly increases for both government bonds and corporate bonds. The highest ratio among all emerging East Asian economies in Q4 2015 belonged to the Republic of Korea (132.5%), followed by Malaysia (96.7%) and Singapore (79.2%).

LCY bond issuance in emerging East Asia in Q4 2015 reached USD1,060 billion, of which 63.3% comprised

[1] Emerging East Asia comprises the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.

government bond sales and 36.7% comprised corporate bond sales. Issuance in Q4 2015 was lower than in Q3 2015 due to a q-o-q decline in the issuance of government bonds, including Treasury bonds and bonds issued by central banks and monetary authorities. However, issuance was up from Q4 2014 on the back of y-o-y increases in the issuance of Treasury bonds and corporate bonds. The PRC remained the largest source of LCY bond issuances in the region in Q4 2015.

Structural Developments in LCY Bond Markets

Foreign investors' holdings of LCY government bonds as a share of the total market remained broadly stable in Q4 2015 in emerging East Asia. The share of government bonds held by foreign investors rose in Indonesia and Malaysia, and fell in Thailand. The share of foreign investors' holdings in the Republic of Korea also fell in Q3 2015, the latest quarter for which data are available. Foreign holdings as a share of the LCY corporate bond market continued to pale in comparison to foreign holdings in the LCY government bond market in both Indonesia and the Republic of Korea.

Net foreign capital inflows were recorded in the LCY bond markets of Indonesia, Malaysia, and Thailand in Q4 2015, while net outflows from the Republic of Korea's bond market were observed during the same period.

LCY Bond Yields

Yields for LCY government bonds decreased for most maturities in nearly all emerging East Asian markets between 1 January and 15 February. The 10-year yield declined in all of the region's markets except the PRC's. During the same period, the spread between yields for the 2-year and 10-year maturities narrowed in all markets except Indonesia's.

Credit spreads between AAA-rated corporate bonds and government bonds generally fell in the PRC and the Republic of Korea between 1 January and 15 February, while spreads rose in Malaysia. During the same period, credit spreads widened between AAA-rated and lower-rated corporate bonds in Malaysia, but remained mostly unchanged in the PRC and the Republic of Korea.